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E.O. 12958: N/A
TAGS: ECON EFIN KCOR PGOV KE
SUBJECT: IMF MISSION VISITS KENYA, WANTS TO EXTEND PROGRAM AND STAY ENGAGED

REF: A. Nairobi 4631, B. Nairobi 4421, C. Nairobi 4321, D. Nairobi

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¶1. (SBU) Summary: The IMF wants to remain engaged in Kenya, and has therefore temporarily extended until February 2007 its three-year, $240 million Poverty Reduction and Growth Facility (PRGF), which had been set to expire this month. It hopes by early 2007 to complete the program's second review, badly delayed due to past and ongoing concerns about Kenya's commitment to dealing with high-level corruption. To achieve completion of the second review, the IMF is asking Kenya to implement a number of governance reforms now in the works, achieve progress on key corruption prosecutions, and resolve the Charterhouse Bank money laundering saga. We support the IMF's decision to continue its engagement with Kenya, but also strongly support its conditionality on governance issues. End Summary.

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IMF Mission: Trying to Complete the Second Review
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¶2. (U) A seven-person mission from the International Monetary Fund (IMF) visited Kenya November 1-15, led by David Andrews, Assistant Director of the IMF's Africa Department. The mission briefed development partners on November 2, and Nairobi-based IMF Resident Representative Scott Rogers provided an out-brief to donors on November 20. Andrews and Rogers also met with the Ambassador and Econ/C on November 3.

¶3. (SBU) The IMF mission came with two purposes. The first was to conduct the annual Article 4 review, overdue by one year. The second more sensitive issue was to negotiate with Kenyan authorities on how to complete the second review of Kenya's three-year, $240 million Poverty Reduction and Growth Facility (PRGF). As the mission arrived, the PRGF, established in November 2003, was due to expire having only completed one of the prescribed six reviews. The second review has been delayed by over a year due to serious concerns on the part of the IMF and key shareholders (including the U.S.; see ref D) about the commitment of the Government of Kenya (GOK), and in particular its senior leadership, to fighting grand-scale corruption. The last IMF mission, which visited in May, 2006, made no progress on issues of governance and corruption because GOK interlocuters simply refused to discuss them.

Macro: Pretty Clear Sailing

¶4. (SBU) In both the in-brief and the out-brief, donors heard that

the IMF is generally pleased with Kenya's macro-economic performance. The IMF projects GDP growth will be 6.1% this fiscal year (ending in June 2007). Average annual overall inflation will moderate to 7.6% (from 11.1% in June 2006) due to expectations of sharply lower food prices and further monetary tightening in the months ahead. The IMF attributes the strong GDP figures in part to the strength of the tourism industry and recovery from the drought. While recurrent expenditure is expected to be stable, development expenditure will rise to 5.8% of GDP (from 4.1%). However, the overall fiscal deficit is projected to moderate slightly to 4.4% of GDP (from 4.6%). The debt-to-GDP ratio is expected to rise modestly; the IMF characterizes it as "manageable."

¶5. (SBU) In the November 2 briefing, Andrews nonetheless reiterated the IMF's consistent view that Kenya's current growth spurt is a recovery phase that cannot be sustained without additional structural reforms to the economy. To achieve a sustainable high growth path, Andrews said, requires reforms in a number of areas. Kenya, he said, was lagging behind in the overall reform effort relative to its neighbors in the region.

Governance: The Unifying Theme

¶6. (SBU) Governance was the unifying theme of the mission's visit, according to Resrep Scott Rogers, who described the discussions in this area as frank and "very productive." The common reference point for the dialogue was a recently completed World Bank assessment of governance in Kenya. That document, in turn, focused its analysis on the GOK's Action Plan on Governance, a lengthy compendium of ongoing and planned measures and reforms across many sectors designed to enhance the institutional capacity of the country to prevent, investigate, and prosecute corruption cases. When the IMF mission visited in May, the GOK was unwilling even to share the draft document. Rogers reported that in its discussions with the

GOK, the IMF mission pushed to incorporate specific measures from the Action Plan for into conditionality for completion of the second review. Which measures are chosen and on what timetable, we inferred, will be subject to ongoing negotiations between the IMF and the GOK. But Rogers indicated they are likely to include reforms to the judicial process to prevent unnecessary delays in the prosecution of high-level graft cases, greater transparency for the wealth declarations of senior GOK officials, and increasing the number of judges in the judiciary. (Note: There are currently only 56 high court and appeals court judges in Kenya. End note).

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IMF Wants Action on Prosecutions and Charterhouse Bank
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¶7. (SBU) Also critical to successful completion of the second review, according to Rogers, is forward movement on prosecutions of senior-level GOK officials in the Anglo-Leasing series of procurement scams. Although a great deal of evidence has come to light, much of it publicly, Kenya's anti-corruption investigators and its Department of Public Prosecutions have been unable to agree on moving case files against 12 senior officials into the courts for prosecution (ref A). The ensuing gridlock has generated the well-founded perception among the public and donors that there is a systemic absence of political will within the GOK to bring the perpetrators of grand-scale corruption to justice.

¶8. (SBU) Another prerequisite for completion of the second review is satisfactory handling by the GOK of the Charterhouse Bank money laundering and tax evasion scam (ref B). Thus far, the bank remains closed and under Central Bank of Kenya-appointed statutory management. While the statutory manager and the CBK are being aggressively challenged in court by Charterhouse's owners and their proxies, the Minister of Finance has thus far refused to resolve definitively the situation by revoking the bank's license and authorizing the CBK to liquidate it. According to Andrews and Rogers, the IMF mission received assurances from Minister of Finance Amos Kimunya that Charterhouse will not be allowed to reopen. The current plan is simply to let the license expire when it comes up for annual renewal at the end of the year, and liquidate the bank thereafter. (Comment: We believe Charterhouse is likely to

challenge this decision in the courts, dragging out the saga. End Comment.)

Next Steps: Hoping to Extend the PRGF

¶9. (SBU) Assuming these various conditions are met and agreed upon between the GOK and the IMF, the plan is to bring the Article 4 review and the second review of the PRGF to the IMF Board in late January or early February. Meanwhile, on November 19, the PRGF was extended until the end of February. If the second review is completed and approved by the Board in January or February, then a second, longer extension of the program woud be requested, and the IMF would then try to complete the 3rd review in June or July for approval by the IMF Board in October 2007.

Comment: IMF on Right Track

¶10. (SBU) The IMF wants to complete the second review and keep the PRGF alive as a means of maintaining engagement and oversight going into Kenya's national elections, expected to be held in late 2007. We agree with this reasoning and therefore support the temporary extension and determination to complete the second review early next year. But we also strongly agree with the IMF's conditions for completion, namely meaningful movement on the Anglo-Leasing prosecutions, implementation of key elements of the Governance Action Plan, and definitive resolution of the Charterhouse Bank scandal. Closing and liquidating Charterhouse and moving against its owners is in our view a litmus test of the GOK's willingness to police Kenya's financial sector and combat corruption.

¶11. (SBU) Unfortunately, there is no guarantee the GOK will be willing to meet any or all of these conditions. GOK officials have become increasingly resistant to foreign advice and conditionality, emphasizing the GOK's ability to self-fund its operations through tax collection and local borrowing. Many also often cite China as an alternative source of assistance -- typically with few or no conditions. Further, the recent reappointment of two ministers forced to resign less than a year ago for their involvement in the Anglo-Leasing and Goldenberg mega-scandals is but the latest signal

that in an election year, efforts against grand-scale corruption may take a backseat.
Ranneberger